
April 19, 2006



Financial Management

Report on DoD Compliance with the Prompt Payment Act on Payments to Contractors (D-2006-076)

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Acronyms

EFT	Electronic Funds Transfer
DFAS	Defense Finance and Accounting Service
MOCAS	Mechanization of Contract Administrative Service



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April 19, 2006

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE, HEADQUARTERS
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE, COLUMBUS

SUBJECT: Report on DoD Compliance with the Prompt Payment Act on Payments to
Contractors (Report No. D-2006-076)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Finance and Accounting Service Columbus comments were partially responsive. We request additional comments on Recommendations a.3 and b.1. We request that the Central Site Deputy Director, Defense Finance and Accounting Service Columbus provide comments on Recommendations a.3 and b.1 by May 19, 2006.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Audcolu@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400 ext. 211 or Mr. Mark Starinsky at (614) 751-1400 ext. 231. For the report distribution, see Appendix C. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Paul J. Granetto", is positioned above the typed name.

Paul J. Granetto, CPA
Assistant Inspector General
Defense Financial Auditing
Service

Office of the Inspector General of the Department of Defense

Report No. D-2006-076

(Project No. D2005-D000FJ-0026.000)

April 19, 2006

DoD Compliance with the Prompt Payment Act on Payments to Contractors

Executive Summary

Who Should Read This Report and Why? DoD personnel responsible for processing contractor payments in accordance with the Prompt Payment Act should read this report. It discusses internal controls that ensure payments are made on time and that the appropriate interest is paid.

Background. The Prompt Payment Act of 1998, section 3903, title 31, United States Code (31 U.S.C. 3903), requires agencies to make payment no later than 30 days after an invoice is received or by the payment date established in the contract. The Prompt Payment Act also requires an agency to make payment no earlier than 7 days before the required payment date or earlier as determined by the agency on a case-by-case basis. If an invoice is paid later than 30 days after the invoice is received or later than the payment date established in the contract, the Government is required to pay interest to the contractor. The Prompt Payment Act governs a large portion of the payments made at Defense Finance and Accounting Service Columbus. In FY 2004, Defense Finance and Accounting Service Columbus made annual payments to contractors subject to the Prompt Payment Act totaling \$34.7 billion.

Results. Defense Finance and Accounting Service Columbus paid the majority of the contractor invoices it received in FY 2004 in accordance with the requirements of the Prompt Payment Act. However, in some instances it made payments without using the correct receipt, payment, or due dates on the invoices. These errors occurred for a projected 61,470 (10.7 percent) of the 577,142 invoices paid; this resulted in incorrect interest payments and noncompliance with certain provisions of the Prompt Payment Act. We calculated that Defense Finance and Accounting Service Columbus incurred a projected \$850 thousand in interest errors through overpayments and underpayments in FY 2004. We also determined that Defense Finance and Accounting Service Columbus made early payments that contributed to \$919 thousand in lost Federal interest. Defense Finance and Accounting Service Columbus needs to improve controls over the process of calculating payment due dates and calculating interest payments to contractors. See the Finding section of the report for the detailed recommendations.

Management Comments and Audit Response. The Central Site Deputy Director, Defense Finance and Accounting Service Columbus, concurred and planned to update the Prompt Pay process, including changing the Mechanization of Contract Administration Service process, and providing refresher training to DFAS personnel to ensure that invoices are paid in accordance with the Prompt Payment Act. In general, the comments were responsive; however, we request that the Central Site Deputy Director, Defense

Finance and Accounting Service Columbus provide additional comments regarding his proposed actions to provide his staff with refresher training and make a change in the payment system. We request that the Central Site Deputy Director, Defense Finance and Accounting Service Columbus provide comments on the final report by May 19, 2006. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

Defense Finance and Accounting Service (DFAS) Columbus records indicated its Contract Pay Product Line division paid about \$115 billion to contractors in FY 2004. Of the \$115 billion in contractor payments, DFAS provided documentation that showed that about \$34.7 billion met the cash management requirements of the Prompt Payment Act of 1998.

The Prompt Payment Act of 1998, section 3903, title 31, United States Code (31 U.S.C. 3903), requires that the Government pay invoices 30 days after it receives them or by the payment date established in the contract. The Prompt Payment Act also requires an agency to make payment no earlier than 7 days prior to the required payment date. The agency can allow earlier payment of invoices on a case-by-case basis. If an invoice is paid later than 30 days after it is received or later than the payment terms established in the contract, the Government is required to pay interest to the contractor.

DFAS Columbus and Mechanization of Contract Administration Service (MOCAS). The Contract Pay Product Line uses MOCAS, an electronic integrated system for contract administration. MOCAS automatically calculates the due date of a payment based on the terms in the contract and upon the receipt of a proper invoice. MOCAS is designed to hold the invoice for payment until 7 days prior to the payment due date. On that day, MOCAS releases the invoice for payment. If the date MOCAS processes the invoice occurs after the MOCAS-calculated due date, MOCAS should generate and send a report to the DFAS Columbus Prompt Payment Interest Branch for further review.

Prompt Payment Interest Branch. The DFAS Columbus Prompt Payment Interest Branch (Interest Branch) reviews all invoices that MOCAS shows as late to determine if interest is due. Once DFAS personnel make the determination that interest is due, they enter the required information in the Prompt Payment Application System, which then makes the interest payment. Documentation of the interest payment is then scanned into an Electronic Data Management system.

Objectives

The audit objective was to determine whether DFAS Columbus was properly paying contractor invoices that were subject to the Prompt Payment Act and whether DoD was properly following the Prompt Payment policy set forth by the Office of Management and Budget. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology and prior coverage related to the objective.

Managers' Internal Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of DFAS Columbus management controls over the compliance with the Prompt Payment Act. Specifically, we determined whether DFAS Columbus controls prevented noncompliance with the Prompt Payment Act. We also reviewed the adequacy of management's self-evaluation of those controls.

Adequacy of Management Controls. We identified material management control weaknesses for DFAS Columbus, as defined by DoD Instruction 5010.40. The DFAS Columbus management controls for complying with the Prompt Payment Act were not adequate. The recommendations in this report, if implemented, will correct the identified weaknesses. A copy of the report will be provided to the senior officials responsible for management controls in DFAS Columbus.

Adequacy of Management's Self-Evaluation. DFAS officials identified the compliance with the Prompt Payment Act as an assessable unit. However, DFAS did not identify any material control weaknesses related to the assessable unit because the scope of their review was not adequate.

Compliance with the Prompt Payment Act

DFAS Columbus paid most of the contractor invoices it received in FY 2004 in accordance with the requirements of the Prompt Payment Act. However, in some instances DFAS personnel or MOCAS, its contractor payment system, generated errors by not selecting the correct invoice receipt, payment, or due date. These problems occurred for a projected 61,470 (10.7 percent) of the 577,142 invoices paid. These errors resulted in incorrect payments of interest and noncompliance with provisions of the Prompt Payment Act. DFAS Columbus did not have the necessary controls in place or controls were not operating effectively to ensure provisions of the Prompt Payment Act were met. We calculated that DFAS Columbus incurred a projected \$850 thousand in interest errors through overpayments and underpayments in FY 2004. We also determined that DFAS Columbus made early payments that contributed to \$919 thousand in lost Federal interest. The interest errors and lost Federal interest occurred as a result of the weak control environment (see Appendix B for statistical methodology and projection estimates).

Sample Selection to Determine Compliance with the Prompt Payment Act.

Total FY 2004 Payments (Commercial Pay Product Line). We received a database from DFAS Columbus that contained all cash managed payments it made in FY 2004 through MOCAS. We classified the payments into three categories: invoices that DFAS Columbus potentially paid early based on the receipt and processed date, invoices that DFAS Columbus appeared to have paid on time based on the receipt and processed date, and invoices that DFAS Columbus appeared to have paid late by no more than one year. Table 1 shows that, according to MOCAS records, DFAS Columbus paid the majority of the invoices on time. The On-Time population comprises 85 percent of the number of invoices and 82 percent of the disbursement amounts. However, a sizeable number of invoices appear to have been paid early or late.

Table 1. Number of Invoices DFAS Columbus Paid in FY 2004 Using MOCAS

<u>Category</u>	<u>Number of Invoices</u>	<u>Dollar Value (in billions)</u>
Early	75,211	\$ 4.5
On Time	488,489	28.4
Late (less than a year)	13,442	1.8
Total	577,142	\$34.7

We statistically selected 300 sample payments from each category for analysis. We tested the 900 sample items to determine if DFAS Columbus complied with selected requirements of the Prompt Payment Act. Specifically, we determined whether DFAS Columbus:

- used the proper receipt date,
- properly calculated the payment due date,
- properly paid the invoice early to take a discount or DFAS personnel obtained approval for an early payment,
- paid the invoice late. In this case, we evaluated whether DFAS paid the correct amount of interest to the contractor.

Noncompliance with the Prompt Payment Act

DFAS Columbus did not always make payments in compliance with provisions of the Prompt Payment Act. Specifically, DFAS Columbus sometimes used an invoice receipt date that violated the Prompt Payment Act. In addition, DFAS Columbus sometimes improperly calculated the number of days the Government kept an improper contractor invoice before returning it to the contractor. Further, DFAS Columbus paid some invoices early and without the proper approval required by the Prompt Payment Act. Most of these errors occurred in the samples of invoices that showed early or late payments.

Proper Invoice Receipt Date. DFAS Columbus personnel selected the wrong date from dates printed on the invoice or failed to use the later of acceptance or invoice receipt date for 96 sample invoices. The Prompt Payment Act requires that the payment terms start on the day that the Government receives a proper invoice or the date the Government accepts the goods or services, whichever is later. For example, if the contractor submitted an invoice on December 1, 2004, but the Government did not receive the goods until December 15, 2004, the payment terms would start on December 15, 2005. The use of an improper receipt date did not always result in an over or under payment of interest, or early payment of an invoice, but it did increase the risk that these errors could occur.

For example, if the proper invoice receipt date was November 1, and DFAS Columbus used an incorrect receipt date of November 15, October 15, or November 3, the effect of the incorrect receipt date would be different. The following table demonstrates how the incorrect receipt date could result in a payment that violates the Prompt Payment Act.

Table 2. Examples of Results of Selecting an Incorrect Invoice Receipt Date

Actual Invoice Receipt Date	Actual Payment Due Date	Allowable Payment Window	Incorrect Invoice Receipt Date	Payment Made Window	Result	Effect
Nov. 1	Dec. 1	Nov. 25- Dec. 1	Nov. 15	Dec. 8-15	Late	Interest Due and Not Paid
Nov. 1	Dec. 1	Nov. 25- Dec 1	Oct. 15	Nov. 8-15	Early	Interest Lost
Nov. 1	Dec. 1	Nov. 25-Dec.1	Nov. 3	Nov. 28- Dec. 3	On Time if Paid Nov. 28- Dec. 1	No Effect
					Late if Paid Dec. 2-3	Interest Due and Not Paid

Processing Improper Invoices. DFAS Columbus sometimes miscalculated the payment due date because it received an improper invoice from the contractor.

The Prompt Payment Act states:

When an invoice is determined to be improper, the agency shall return the invoice. . . no later than 7 days after receipt. When an agency fails to make notification of an improper invoice within seven days. . . the number of days allowed for payment of the corrected proper invoice will be reduced by the number of days between the seventh day. . . and the day notification was transmitted to the vendor [contractor]. Calculation of interest penalties, if any, will be based on an adjusted due date reflecting the reduced number of days allowable for payment.

DFAS Columbus tracked the receipt and contractor notification of improper invoices in the MOCAS system by assigning an “E” to the “Remarks” field associated with the invoice. They also assigned a code in MOCAS to explain why the invoice was improper. In accordance with the Act, DFAS was granted up to 7 days to notify the contractor of an improper invoice without adjusting the invoice due date. If DFAS did not notify the contractor within 7 days, it was required to reduce the payment due date by the number of days it took to notify the contractor of the improper invoice less the 7 days allowed by the Act. For 19 sample items DFAS incorrectly calculated the number of days that it held an invoice for review.

For example, if an improper invoice was received on November 1, 2004, and returned to the contractor on November 15, 2004, DFAS Columbus should reduce the payment due date by 8 days (15 days to process the invoice minus the 7 days allowable by the Prompt Payment Act). However, if DFAS did not factor in the improper invoice, it would calculate the payment due date later than required and possibly make a late payment without paying interest. For these 19 sample invoices, the miscalculation did not always result in a payment of an invoice

earlier than allowable by the Prompt Payment Act, but the problem did increase the risk that late payments would occur.

Calculating Payment Date and Payment Due Date. The Prompt Payment Act states that the payment due date is the date on which payment should be made. It is generally 30 days after the receipt of a proper invoice. The Prompt Payment Act defines a payment date as the date on which a check for payment is dated or as the date of an electronic fund transfer (EFT) payment (settlement date). The settlement date is further defined as the date on which an EFT payment is credited to the contractor's financial institution.

Of the 900 sample items, DFAS Columbus incorrectly calculated the due dates of 69 sample invoices and incorrectly calculated the payment dates for 35 sample invoices. Although the incorrect calculation did not always result in an error in the calculation of interest, it did increase the risk that an error could occur.

Releasing an Invoice Early. The Prompt Payment Act states that an agency must make payments no more than 7 days prior to the payment due date, unless the agency head or designee has determined (on a case-by-case basis) that earlier payment is necessary. According to the Prompt Payment Act, this authority must be used cautiously, weighing the benefits of making a payment early against the good stewardship inherent in effective cash management practices.

Although required by the Prompt Payment Act, DFAS Columbus could not provide evidence that the agency head or designee had determined, on a case-by-case basis, that early payment of 58 sample items was necessary. DFAS Columbus personnel and its invoice payment system made an early payment for 58 sample invoices without this documentation.

Controls over Compliance with the Prompt Payment Act

We calculated that DFAS did not comply with the Prompt Payment Act on a projected 61,470 invoices. We concluded the noncompliance resulted from lack of adequate internal controls. Specifically, the Interest Branch did not adhere to controls over analyzing interest due and making interest payments. Additionally, certain MOCAS systems controls were not in place, controls over the input of invoice information were not adequate, and controls over the early release of invoices were not operating effectively.

Table 3 shows the number of invoices paid in FY 2004 that we estimate were affected by these control weaknesses.

Table 3. Number of Invoices Affected by Control Weaknesses	
<u>Control Weakness</u>	<u>Invoices Paid</u>
Interest Branch errors	4,705
Incorrect MOCAS system programming	15,871
Determining the invoice receipt date	24,530
Preventing early release of invoices	18,723
<p>Note: The 61,470 invoices with projected errors is not the sum of the errors associated with each control weakness because each invoice could have more than one error. See Appendix B for more details on the projection.</p>	

Interest Branch Controls. The Interest Branch had several inadequate controls in place which caused DFAS to be in noncompliance with the Prompt Payment Act. The Interest Branch incorrectly analyzed 4,705 invoices as a result of these inadequate controls. Table 4 shows the three primary Interest Branch control weaknesses related to the 300 late sample items.

Table 4. Control Weaknesses in the Interest Branch	
<u>Control Weakness</u>	<u>Number of Invoices</u>
Noncompliant policy to extend weekend and holiday due dates	49*
Inadequate policy to determine EFT payment dates	32*
Inadequate controls to prevent incorrect interest payments	31
<p>*For 7 invoices, the Interest Branch both incorrectly adjusted the due date and incorrectly determined the payment date.</p>	

Policy to Extend Due Date. DFAS Columbus underpaid interest on 49 invoices because an Interest Branch unwritten policy caused personnel to improperly move payment due dates from a weekend or holiday to the next business day. This DFAS policy was not in compliance with the Prompt Payment Act because it extended due dates beyond the 30-day limit established in the law. The DFAS policy will also result in an underpayment of interest when invoices are paid late.

The Prompt Payment Act states that if the payment due date is on a weekend or holiday and payment is made the following business day, no interest is due. For example, if the payment due date is July 3, 2004 (a Saturday), and payment is made on July 6, 2004 (the next business day, a Tuesday), there is no interest due.

However, the Prompt Payment Act does not permit a recalculation of the due date if the due date falls on a weekend or holiday and payment is made more than one business day after the weekend or holiday (when calculating the number of days late). For example, if the payment due date was on July 3, 2004 (a Saturday), and the invoice was paid on July 15, 2004 (a Thursday), then interest should have been calculated on the 12 days. However, the Interest Branch policy moved the due date to July 6, 2004 (the next business day), which resulted in interest calculated on just 9 days late. Therefore, the Interest Branch policy underpays interest to the contractor when the due date falls on a weekend or holiday.

Determining Payment Date. The Interest Branch policy for calculating the payment date for EFT payments resulted in the underpayment of interest on 32 invoices. The Prompt Payment Act states that the payment date for an EFT payment is the settlement date, which is when the payment is applied to the contractor's bank account. MOCAS processed an EFT payment as the date DFAS sent the payment information to the financial institution, usually the business day before the payment was applied to the contractor's bank account. The Interest Branch routinely added one day to the MOCAS-processed date to determine the EFT payment date.

This policy created an underpayment of interest for 32 sample invoices because the MOCAS-processed payment date fell on a Friday or the day before a holiday. When the Interest Branch moved the EFT payment date to the next day, they did not calculate the weekend or holiday so they did not use the next business day. For example, in one instance DFAS Columbus processed the invoice for EFT payment on February 27, 2004 (a Friday). When the Interest Branch reviewed the invoice, they used February 28, 2004 (a Saturday), as the payment date. The Interest Branch should have used March 1, 2004 (a Monday), as the payment date. Because of the incorrect payment date, the Interest Branch calculated the interest on two fewer days and underpaid the contractor \$230.37. In instances when the MOCAS-processed date occurred on a Friday or holiday, the Interest Branch policy to move the payment date just one day resulted in an underpayment of interest. This practice was not in accordance with the provisions of the Prompt Payment Act.

Calculating Interest Using Correct Data. The Interest Branch personnel selected incorrect information, such as the incorrect invoice receipt date, in determining the interest calculation for 31 invoices. They used an incorrect receipt date although the Interest Branch provided detailed training on selecting and using the correct date. The training information adhered to the provisions of the Prompt Payment Act. In addition, the Interest Branch required analysts to review the interest documentation before payment to ensure that the receipt date and other data were correct. These controls should have prevented the majority of

instances where the Interest Branch paid an incorrect amount of interest but did not.

In some cases, when another Government agency was the designated receiving office, the Interest Branch used the invoice receipt date, as opposed to the later acceptance date, or used the MOCAS receipt date. We asked the Interest Branch to perform further review on 22 of the 31 sample invoices that included incorrect information. The Interest Branch agreed with our analysis for 13 of the 22 invoices; personnel took action on 9 of those invoices to make additional interest payments of \$4,496.63 and issue a credit of \$349.22 to be collected for overpayments. For 4 of the 13 invoices, Interest Branch personnel took no additional action. They indicated that at the time they reviewed these 4 invoices, they had followed a DFAS policy related to the calculation of improper invoices that they later discontinued. These invoices need additional action because, while the Interest Branch might have previously followed DFAS policy at the time, DFAS policy was not in accordance with the Prompt Payment Act.

For another 18 invoices, Interest Branch personnel stated that the interest payments were processed in accordance with the Prompt Payment Act or that they had not reviewed the interest payments further. However, we continue to disagree that these invoices were paid in accordance with the Prompt Payment Act. Personnel need training that emphasizes calculating the correct invoice date and using the correct receipt date when calculating interest due.

MOCAS Controls. Certain MOCAS controls to ensure compliance with the Prompt Payment Act were not in place and operating effectively. Specifically, we projected that 15,871 invoices were affected by MOCAS control weaknesses which did cause, or could have caused, DFAS Columbus to be in noncompliance with the Prompt Payment Act. Table 5 shows a breakdown of the major MOCAS control weaknesses by sample results.

Table 5. Control Weaknesses in MOCAS	
<u>Control Weakness</u>	<u>Number of Invoices from Samples</u>
Calculating correct number of days related to receiving and review an improper invoice	12
Identifying an invoice that requires an interest payment	21
Calculating the later of acceptance versus invoice receipt date	16
Unexplained calculations	21
Determination of discounts	5

Calculating Correct Payment Due Dates When a Contractor Has Previously Submitted Improper Invoices. MOCAS improperly calculated the payment due date on 12 invoices because it did not properly subtract all the days associated with multiple improper invoices submitted by the contractor. Improper invoices are identified with E-codes in MOCAS, and the MOCAS system is designed to then take any number of days over 7 days and subtract them from the due date calculated for the proper invoice.

MOCAS system personnel indicated that MOCAS was designed to calculate a due date based on only one improper invoice submitted by the contractor. Therefore, if a contractor submitted several improper invoices that were returned outside of the 7 day allowable time frame, MOCAS would not reduce the 30 day payment due date by all of the days it should. More than one improper invoice was submitted on eight sample invoices. This resulted in DFAS not properly identifying invoices that were paid late and not researching the interest payment due.

Table 6 shows how MOCAS incorrectly calculated the due date when there were two improper invoices received. Based on the MOCAS calculated due date as shown in the table, DFAS Columbus paid the invoice on November 5, 2003, which was actually 10 days later than allowable by the Prompt Payment Act (October 26, 2003, through November 5, 2003).

Table 6. Improper Invoice Calculation

	<u>Improper Invoice Received</u>	<u>Improper Invoice Returned</u>	<u>Extra Days to Reduce the Due Date</u>	<u>Proper Invoice Received</u>	<u>Due Date</u>
Calculation as required by the Prompt Payment Act	April 21, 2003	May 14, 2003	16	October 20, 2003	October 26, 2003
	June 24, 2003	July 9, 2003	<u>8</u>		
Total Extra Days			24		
MOCAS calculation	April 21, 2003	May 14, 2003	0	October 20, 2003	November 11 , 2003
	June 24, 2003	July 9, 2003	<u>8</u>		
Total Extra Days			8		

In addition, for four invoices, MOCAS improperly subtracted days from the payment due date in circumstances when an improper invoice was received after the proper invoice. Contractors sometimes submit invoices after DFAS has received a proper invoice. This contributed to DFAS Columbus making a payment earlier than allowable by the Prompt Payment Act.

Identifying Invoices that Require an Interest Payment. MOCAS did not identify 21 sample invoices as late that it should have identified as late and provided to the Prompt Payment Interest Branch for further review. Specifically, MOCAS should identify an invoice as late if the Processed Date field is later than the Due Date field. However, in six instances when the processed date was later than the due date, MOCAS did not identify these invoices as paid late. In addition, the Processed Date field in MOCAS was generally not the payment date as defined by the Prompt Payment Act. The MOCAS processed date was the date the invoice was processed for payment. Because the actual paid date for EFT payments is defined by the Prompt Payment Act as the day the payment is credited to the contractor's banking institution, invoices that are technically one day late will not be identified in MOCAS as late. We identified 15 instances where this occurred. If MOCAS does not identify an invoice as late, then DFAS has a risk that required interest will not be paid.

Calculating the Later of Acceptance and Invoice Receipt Date. MOCAS incorrectly calculated the payment due date by not using the later of the invoice receipt date or acceptance date for 16 sample invoices. MOCAS generally calculated the later of acceptance and invoice receipt correctly, but not always. We discussed this weakness with DFAS systems personnel. They could not explain why the incorrect receipt date was used in calculating the due date.

Unexplained Calculations. MOCAS did not correctly calculate the due date for 24 sample invoices. For example, MOCAS calculated the due date on one invoice 20 days after the invoice receipt date instead of the standard 30 days. We could not determine why MOCAS did not correctly calculate the due date. DFAS Columbus was also unable to provide an explanation for this error. DFAS Columbus needed to determine how the due dates were calculated. If MOCAS does not correctly calculate the payment due date, there is a risk that DFAS will not pay the invoice in accordance with the Prompt Payment Act.

Determination of Discounts. MOCAS calculation of discounts and early release based on discounts was not adequate and did not comply with the Prompt Payment Act on five sample invoices. Two invoices related to a contract that had prior interim financing payments. MOCAS calculated the discount based on the total invoice price, not the amount the contractor should have been paid, which resulted in excess credits taken from the contractor. In one instance, MOCAS paid an invoice within the discounted time frame but did not take the correct discount. In two other instances, MOCAS applied the discount outside the allowable time frame. If MOCAS continues to take discounts outside of the allowable time frame, DFAS will continue to violate the Prompt Payment Act.

DFAS should ensure that MOCAS properly identifies discounts in the allowable time frame and calculates the discount accurately.

Invoice Receipt Date Controls. Certain invoice receipt date input controls were in place to ensure the proper invoice receipt date was used. However, the controls were not operating effectively. We projected that DFAS Columbus entered incorrect invoice receipt dates for 24,530 invoices.

Table 7 shows the reasons DFAS did not select the correct receipt date to enter into MOCAS for 76 of the 900 sample items.

Table 7. Invoice Receipt Control Weaknesses	
<u>Causes of Error</u>	<u>Number of Invoices</u>
Selecting an incorrect government representative receipt date	18
Selecting an incorrect faxed invoice date	35
Selecting an incorrect scanned/electronic invoice	23

Selecting an Incorrect Government Representative Receipt Date. For 18 sample invoices where the official government representative was not DFAS Columbus, DFAS used the date it received the invoice from the government representative, not the date the government representative received the invoice. If the government representative did not date the invoice, then the contractor-provided invoice date is the proper invoice receipt date. For these 18 invoices, DFAS Columbus did not select the proper date. Instead, in most instances, the DFAS Columbus receipt date was used. This control weakness will cause MOCAS to calculate a due date later than acceptable and could result in a late payment that MOCAS would not flag for review by the Prompt Payment Interest Branch. It will also result in an underpayment of interest to the contractor.

Selecting an Incorrect Faxed Invoice Receipt Date. For 35 sample invoices, the fax header date did not match the MOCAS receipt date. Personnel from the two directorates in DFAS which enter receipt dates (Entitlement and Tier II) stated that they do not use the fax header information because it comes from the sender and they have no assurance that the time and date information was correct. According to DFAS Columbus, Electronic Data Management automatically assigns the date when the invoice is scanned and then populated MOCAS with the receipt date. They could provide no assurance that the faxed invoices were scanned by the day of receipt. They stated that MOCAS will sometimes stamp a date on a faxed invoice, but not often. This practice does not provide enough reliability that the MOCAS date is correct.

DFAS reviewed 16 of the faxed invoices that had different fax header dates than MOCAS and agreed that seven of the fax header dates were correct, as opposed to the MOCAS receipt date. For two of the invoices where DFAS Entitlement

personnel did not agree the fax header date was correct, the Interest Branch said that the fax header date was correct.

DFAS Columbus needs additional controls over the receipt of faxed invoices to ensure that the faxed invoices are properly stamped with the actual receipt date, not the date scanned by MOCAS.

Selecting an Incorrect Scanned or Electronic Invoice Receipt Date.

The MOCAS receipt date did not match the Electronic Data Management scanned date on the hard copy invoice or electronic invoice receipt date on 23 of the sample invoices. Entitlement and Tier II personnel stated that the discrepancies occurred because the invoice was “restarted” in MOCAS and the incorrect receipt date was selected. An invoice can be restarted by Customer Service or Entitlement directorate personnel when a contractor has questions about the invoice receipt date. DFAS Columbus needs to provide additional training so that the proper receipt date is selected for restarted invoices.

Early Release of Invoices Without Proper Controls. Controls over the early release of invoices from the MOCAS system were not operating effectively. Based on 87 sample invoices, we project that 18,723 invoices were released earlier than 7 days prior to the MOCAS due date without proper approval.

According to DFAS system personnel, MOCAS did not release a cash managed invoice earlier than 7 days prior to the due date unless a manual override was performed. DFAS desk procedures allowed an invoice to be released manually if there was sufficient evidence that the invoice was entered incorrectly and would be late if paid on the MOCAS due date, or if there was further sufficient reason for making an early payment.

As part of its Management Control Program, DFAS Columbus initiated a policy to review the daily report of invoices that had been released from cash management early and to determine if there was proper justification for the early release. We looked at the supporting evidence for early release for one MOCAS directorate. DFAS maintained over 200 early release forms for the West directorate for FY 2004. However, we only found one release form related to our sample items. DFAS Columbus stated that the other two directorates maintain electronic copies of their early release forms, but we could not find any related to our sample items. DFAS Columbus should perform additional analysis to determine if the invoices were released early by MOCAS or were manually released. DFAS Columbus needs to take the necessary corrective action to prevent future unapproved early releases of invoices.

Effect of Noncompliance

As a result of DFAS Columbus noncompliance with the Prompt Payment Act, we project that DFAS Columbus incurred about \$1.8 million in total interest errors on 36,239 invoices. The errors are related to the underpayment of interest, the overpayment of interest, and Federal interest lost due to early payments in FY 2004.

The projected \$1.8 million in total interest errors is related to \$801 thousand of underpayments, \$49 thousand of overpayments, and \$919 thousand of Federal interest lost that we statistically projected. Table 8 shows the interest dollar errors for our 900 sample invoices.

Table 8. Interest Dollar Errors Related to Our Sample

	Projected Dollar Errors
Underpayment of Interest	\$800,745
Overpayment of Interest	48,866
Federal Interest Lost	919,073
Total Interest Errors	\$1,768,684

In calculating the overpayment and underpayment of interest, we used the applicable daily interest rate for each invoice. We then subtracted the amount of interest actually paid on the invoice to arrive at the error. The projected Federal interest lost amount is based on the Treasury Current Value of Funds rate. We calculated the error in interest by taking the disbursement dollar value of the invoice and multiplying that by the applicable interest rate or current value of funds rate.

Although we project that DFAS Columbus made errors on 61,470 invoices, interest errors only occurred on 36,239 of the total projected invoices. The noncompliance and resulting interest errors primarily resulted from DFAS not selecting the correct invoice receipt date or not correctly calculating the due date on the estimated 61,470 invoices. If controls governing compliance with the Prompt Payment Act are not corrected, DFAS Columbus will continue to pay a significant number of invoices incorrectly and violate the provisions of the Prompt Payment Act.

Recommendations, Management Comments, and Audit Response

We recommend that Director, Defense Finance and Accounting Service Columbus direct:

a. The Prompt Payment Branch to implement policies and controls in accordance with the Prompt Payment Act. Specifically:

1. Direct that the due dates that fall on a weekend or holiday not be moved to the following business day for calculating the interest payment.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they will prepare a System Change Request to update the Prompt Pay application accordingly.

2. Direct that the payment date for Electronic Fund Transfer payments be the following business day after the Mechanization of Contract Administration Service processed date.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they will prepare a System Change Request to update the Prompt Pay application to use the day after the MOCAS processed date as the payment date for EFT payments.

3. Ensure that additional training is provided related to selecting proper invoice receipt dates and acceptance dates.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they will provide refresher training for all Entitlement technicians on procedures related to selecting proper invoice receipt dates and acceptance dates.

Audit Response. Management's comments were partially responsive. Although DFAS Columbus concurred with the recommendation, training in selecting proper invoice receipt dates and acceptance dates needs to be provided to Prompt Payment Interest Branch personnel also. Therefore, we request that DFAS Columbus provide additional comments in response to the final report identifying actions to provide training to Prompt Payment Interest Branch personnel.

b. The Mechanization of Contract Administration Service systems personnel to determine compliance with the Prompt Payment Act. Specifically:

1. Ensure that all improper invoices received before the proper invoices that are returned after the allowable 7-day window are factored in the due date.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they will provide refresher training to Entitlement technicians on procedures related to returning improper invoices within the proper 7 day window. Additionally, DFAS will ensure that when invoices are not returned within 7 days, the payment due date will be reduced by the appropriate number of days for all occurrences. Management will take action on the processing of improper invoices with continuous refresher training and by enforcing the timely return of invoices. Management will also add this function as a goal to the Federal Manager's Financial Integrity Act standardized matrix and will evaluate the goal quarterly.

Audit Response. Management's comments were not responsive. Although DFAS Columbus concurred with the recommendation, providing refresher training to Entitlement technicians will not correct the weakness. DFAS Columbus needs to implement a MOCAS system change to account for days

related to all improper invoices to ensure that all late payments are identified and provided to the Prompt Payment Interest Branch for further review. Therefore, we request that DFAS Columbus provide additional comments in response to the final report identifying actions to update MOCAS to account for all improper invoices.

2. Ensure that after the proper invoice is received, improper invoices are not factored in the due date.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they took corrective action to put processes in place to identify potential duplicate invoices for subsequent research. Management will also address the issue during its upcoming refresher training.

3. Ensure that the Mechanization of Contract Administration Service process for calculating due dates is operating effectively.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they will monitor the MOCAS process to ensure that due dates are calculated properly. Management will add this function as a goal to the Federal Manager's Financial Integrity Act standardized matrix and will perform a quarterly review to ensure due dates are calculated correctly.

4. Ensure that all invoices paid after the payment due date are included in the report sent to the Prompt Payment Interest Branch for further analysis.

Management Comments. DFAS Columbus concurred with the recommendation and stated that the MOCAS Systems Branch will perform additional analysis of late payments by comparing a listing of payments made after the due date to the report sent to the Prompt Pay Branch to determine if late payments are made that are not included in the Prompt Pay Report. Management will make changes to the Prompt Pay Report as necessary.

c. Entitlement, Customer Service, and Tier II personnel are adequately trained in determining the correct receipt dates to enter into MOCAS.

Management Comments. DFAS Columbus concurred with the recommendation and stated that they will provide refresher training to Tier II and Entitlement technicians on procedures related to determining the correct receipt dates to enter into MOCAS. Management will also ensure that similar training is provided to Customer Service representatives.

d. Defense Finance and Accounting Service Columbus systems' and Entitlement personnel to determine why invoices are released earlier than 7 days prior to the due date and to take action to ensure that controls are in place to prevent the early release without proper approval and documentation.

Management Comments. DFAS Columbus concurred with the recommendation and stated that a higher level of authorization will now be required for early release of payments. The new procedure only allows the Chief of the Entitlement Division or the Director of Contract Pay Operations to release payments early based on supporting documentation received from a Contracting Officer. Management will perform a periodic review to compare the early release authorizations in MOCAS to the supporting documentation previously scanned into the Electronic Document Management system. Management will also add the approval authority and review functions to the Federal Manager's Financial Integrity Act matrix for the Director of Contract Pay Operations and has added them to the matrix for the Chief of the Entitlement Division.

Appendix A. Scope and Methodology

We requested all invoices paid in MOCAS for FY 2004. We received this information with the disbursement amount by Accounting Classification Reference Number. We then divided the invoices that were potentially early, on time, and late based on the MOCAS receipt date and MOCAS processed date. Our statisticians developed a random sample of each of these populations. For each sample invoice, we determined, through scanned hard copy documents and MOCAS data, whether the invoice was paid in accordance with the Prompt Payment Act. Specifically, we verified that the invoice receipt date, acceptance date, payment date, and payment due date were correct. For those invoices that were paid later than the payment due date, we determined whether the correct amount of interest was paid. For those invoices that were paid earlier than 7 days prior to the payment due date, we verified whether the payment was authorized. We also calculated the interest due or interest lost by taking the disbursement dollar value and multiplying the number of days the invoices was early or late. We then multiplied that amount by the appropriate daily interest rate. For those invoices that showed interest payments, we compared our calculated interest and the actual interest paid to determine the amount of overpayment or underpayment.

We performed this audit from October 2004 through November 2005 in accordance with generally accepted government auditing standards.

We did not verify that MOCAS system data, such as type of acceptance or kind of contract, was accurate.

Use of Computer-Processed Data. We used computer-processed data obtained from the MOCAS system to determine the universe of contractor invoices and acceptance information. We did not perform a formal reliability assessment of the computer-processed data. However, we examined additional supporting documents available from DFAS Columbus to verify the existence of contractor invoices and the accuracy of payments made. We did not rely on MOCAS for invoice receipt dates. Our results were not negatively affected by not performing a formal reliability assessment of MOCAS.

Use of Technical Assistance. We obtained assistance from our Quantitative Methods Division to obtain our sample and to project our sample results. See Appendix B for their detailed methodology.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the financial management high-risk area.

Prior Coverage

During the last 5 years, the Department of Defense Inspector General (DoD IG), has issued one report discussing DFAS Columbus compliance with the Prompt Payment Act. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

DoD IG

DoD IG Report No. D-2004-058, "Early Payment of Invoices by the Defense Finance and Accounting Service Columbus," March 12, 2004

Appendix B. Statistical Methodology

Universe of Cash Managed Sample. The universe data for cash managed invoices paid in FY 2004 through MOCAS was \$34.7 billion. We selected 300 sample items from each category. We used a simple random sample design for sample selection in each population. We determined that 300 items would be an appropriate sample size for an attribute projection based on our calculations, a what-if analysis we had performed, and our professional judgment. Samples were selected without replacement and without regard to dollar value of the item. We used the random number capabilities in SAS version 9.1 to generate the random sample. See Table B-1 for our sample size and universe dollars.

Table B-1. Universe and Sample Size

<u>Sample</u>	<u>Sample Size</u>	<u>Sample Dollars</u>	<u>Population Size</u>	<u>Population Dollars</u>
Early Invoices	300	\$21,545,519	75,211	\$ 4,503,128,396
On Time Invoices	300	\$17,194,951	488,489	\$28,433,890,498
Late Invoices	300	\$32,704,995	13,422	\$ 1,834,028,178

Projection of Sample. Based on the audit results, our statisticians calculated the statistical projections in Table B-2 using the exact binomial model. The exact binomial model produces asymmetrical upper and lower bounds with a 95 percent confidence interval.

Table B-2. Projection of Samples with a 95 Percent Confidence Interval

<u>Control Error</u>	<u>Lower Bound</u>	<u>Point Estimate</u>	<u>Upper Bound</u>
Prompt Payment Interest Branch	3,980	4,705	5,470
MOCAS System	7,430	15,871	24,313
Invoice Input	12,304	24,530	36,755
Early Release	14,511	18,723	22,934
Number of Invoices with Control Errors	47,101	61,470*	75,839

*For 7 invoices, the Prompt Payment Interest Branch both incorrectly adjusted the due date and incorrectly determined the payment date

The statisticians also projected the dollar errors in Table B-3 at a 95 percent confidence level across all samples. Additionally, they projected the total number of invoices with interest errors in Table B-4 at a 95 percent confidence level across all samples.

Table B-3. Projection of Dollar Value Errors with a 95 Percent Confidence Interval

<u>Type of Error</u>	<u>Lower Bound</u>	<u>Point Estimate</u>	<u>Upper Bound</u>
Underpayment	\$349,772	\$800,745	\$1,251,719
Overpayment	6,531	48,866	91,202
Interest Lost	174,888	919,073	1,663,258
Absolute Error	\$899,288	\$1,768,684	\$2,638,081

Table B-4. Projection of Invoices with Dollar Value Errors with a 95 Percent Confidence Interval

<u>Lower Bound</u>	<u>Point Estimate</u>	<u>Upper Bound</u>
25,042	36,239	47,436

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Defense Finance and Accounting Service Columbus Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
P.O. BOX 182317
COLUMBUS OHIO 43218-2317

DFAS-CS/CO

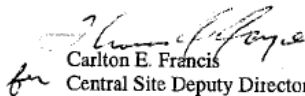
FEB 28 2008

MEMORANDUM FOR DIRECTOR, INTERNAL REVIEW

SUBJECT: Management Comments to Draft Audit Report "DoD Compliance with the Prompt Payment Act on Payments to Contractors," Project Number D2005-D000FJ-0026, dated January 27, 2006

In accordance with subject draft audit report, the Commercial Pay Business Line is submitting the attached management comments.

My point of contact for additional information is Ms. Penny Allen, DFAS-CSQA/CO, at 614-693-8736 or DSN 869-8736.


for Carlton E. Francis
Central Site Deputy Director

Attachment:
As stated

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Management Comments to the Draft Audit Report "DoD Compliance with the Prompt Payment Act on Payments to Contractors," Project Number D2005-D000FJ-0026, dated January 27, 2006

Recommendation a: We recommend that the Director, Defense Finance and Accounting Service Columbus, direct the Prompt Payment Branch to implement policies and controls in accordance with the Prompt Payment Act. Specifically:

Recommendation a.1: Direct that the due dates that fall on a weekend or holiday not be moved to the following business day for calculating the interest payment.

Management Comments: Concur. We agree that the payment due date should not be changed for interest calculation purposes because it falls on a weekend. The movement of due dates identified in the above recommendation occurs only in the mid-tier application where the Prompt Pay interest is calculated. The only time this becomes an issue is when the actual invoice payment date does not occur on the first business day following a weekend or holiday. The actual underpayment for the 49 errors identified in this particular category (reference Table 4 of the audit report), amounts to \$841.80. When compared to the total projected underpayment of \$800,745, as reflected in Table 8, this represents a fraction of the total, or .11 percent. We are in the process of writing a System Change Request (SCR) to have the Prompt Pay application (system) changed accordingly.

Estimated Completion Date: June 30, 2006

Recommendation a.2: Direct that the payment date for Electronic Fund Transfer payments be the following business day after the Mechanization of Contract Administration Service processed date.

Management Comments: Concur. This will require a systems change to the Prompt Pay application. An SCR will be prepared and sent to the Central Design Activity (CDA) for the change to be processed.

Estimated Completion Date: June 30, 2006

Recommendation a.3: Ensure that additional training is provided related to selecting proper invoice receipt dates and acceptance dates.

Management Comments: Concur. We will ensure that refresher training is provided on invoice receipt and acceptance dates. Training will be provided for all entitlement technicians.

Estimated Completion Date: April 1, 2006

Recommendation b: We recommend that Director, Defense Finance and Accounting Service Columbus direct the Mechanization of Contract Administration Service systems personnel to determine compliance with the Prompt Pay Act. Specifically:

Recommendation b.1: Ensure that all improper invoices, received before the proper invoices, that are returned after the allowable 7 day window are factored in the due date.

Management Comments: Concur. We will ensure that the entitlement technicians receive refresher training regarding the proper return of invoices within the 7 day window. When invoices are not returned within 7 days, the due date of the payment will be reduced by the appropriate number of days for all occurrences. We will take action on this processing issue with continuous refresher training and by enforcing the timely return of invoices by all DFAS Accounts Payable employees. Additionally, the CPBL has added this function as a goal to the Federal Manager's Financial Integrity Act (FMFIA) standardized matrices. This goal will be evaluated quarterly.

Estimated Completion Date: April 1, 2006

Recommendation b.2: Ensure that after the proper invoice is received, improper invoices are not factored in the due date.

Management Comments: Concur. While we concur with the recommendation statement, this audit report does not identify this issue as a substantial problem within Contract Pay Operations. We have processes in place today to identify potential duplicate invoices for subsequent research. However, we will reiterate this point during our upcoming refresher training.

Estimated Completion Date: April 1, 2006

Recommendation b.3: Ensure that the Mechanization of Contract Administration Service process for calculating due dates is operating effectively.

Management Comments: Concur. We will monitor the Mechanization of Contract Administration Service (MOCAS) process to ensure that we are calculating due dates properly. Additionally, CPBL will add this function as a goal to the FMFIA standardized matrix. This goal will be reviewed on a quarterly basis.

Estimated Completion Date: March 31, 2006

Recommendation b.4: Ensure that all invoices paid after the payment due date are included in the report sent to the Prompt Payment Interest Branch for further analysis.

Management Comments: Concur. The Systems Branch for MOCAS will perform additional analysis by bumping a listing of payments made after the due date against the report sent to the

Prompt Pay Branch to determine if late payments are made that fail to hit the Prompt Pay Report. An analysis will be completed by April 1, 2006. If necessary, changes to the Prompt Pay Report sent to the Prompt Pay Branch will be made by May 1, 2006.

Estimated Completion Date: May 1, 2006

Recommendation c: We recommend that Director, Defense Finance and Accounting Service Columbus direct that the Entitlement, Customer Service, and Tier II personnel are adequately trained in determining the correct receipt dates to enter into MOCAS.

Management Comments: Concur. Refresher training will be provided to the Tier II and Entitlement technicians. We will also conduct training for Customer Service representatives although they are not directly responsible for entering the various dates into the MOCAS system.

Estimated Completion Date: April 1, 2006

Recommendation d: We recommend that Director, Defense Finance and Accounting Service Columbus direct the Defense Finance and Accounting Service Columbus systems' and Entitlement personnel to determine why invoices are released earlier than 7 days prior to the due date and to take action to ensure that controls are in place to prevent the early release without proper approval and documentation.

Management Comments: Concur. A higher level of authorization will now be required for early release of payments. Only the Chief of the Entitlement Division or the Director of Contract Pay Operations will be authorized to release payments early based on supporting documentation received from a Contracting Officer. A periodic review of early release authorizations in MOCAS will be compared to the supporting documentation previously scanned into the Electronic Document Management (EDM) system. CPBL will add the approval authority and review functions to the FMFIA matrix for the Director of Contract Pay Operations. The approval authority and review functions are currently on the matrix for the Chief of the Entitlement Division. The first periodic review will occur no later than April 30, 2006.

Estimated Completion Date: April 30, 2006

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

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